Economic Update

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Uncertainty Dominates Economic Outlook

The story of the past year goes on: the U.S. economy continues to grow slowly, with stagnant business investment, manufacturing and labor markets. Despite continued growth in the Nation's output – real gross domestic product [GDP] grew at a 2.8 percent annual rate over the four quarters of 2002 – key sectors and markets of the economy remain flat. The Federal Reserve's most recent Beige Book (a report summarizing survey information from Fed district banks) characterized growth as "sluggish" and economic activity as "soft" or "subdued."

An alleviation of domestic and geopolitical risks likely would enhance business and consumer confidence and promote the natural tendency for the economy to return to higher growth and lower unemployment. It is in this context that Congress is considering additional policies to help businesses and families as the Nation faces these uncertainties.

Recent Data

Employment: In January, nonfarm payroll employment rose by 143,000 jobs and the unemployment rate fell to 5.7 percent, down from 6.0 percent in December – a better-than-expected performance.

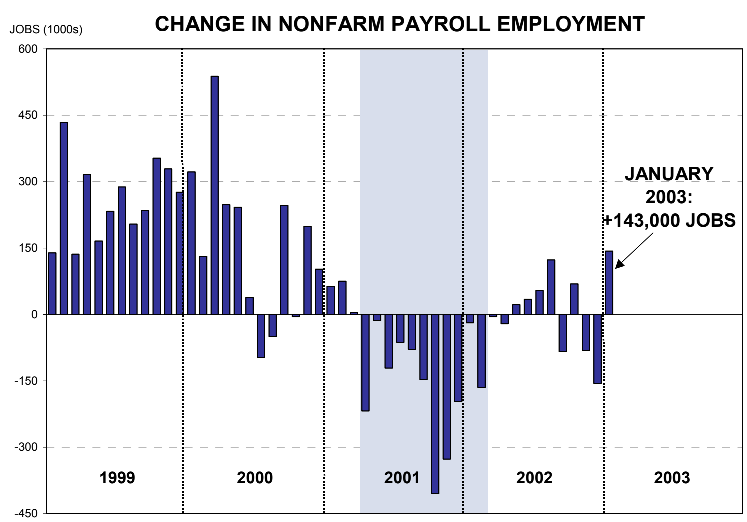
- The unemployment data for January may be unreliable, however, in terms of making month-to-month comparisons. Significant changes are being implemented in the collection and reporting of the data and in the underlying methodologies. Data in subsequent months will be more reliable.

- The increase in jobs in January was the largest increase since November 2000 – prior to the recession. The January increase, however, largely reflects a rebound from a larger decline (-156,000 jobs) that occurred in December (see chart alongside).

On balance, the report indicates little change in the employment situation over the past year, although the increase in jobs in January is certainly welcome. The unemployment rate remains at elevated levels compared to the lows during the 1990s expansion, but well below the highs reached after the 1991-92 recession (7.8 percent).

Real GDP and Productivity: Real GDP grew at a 0.7 percent annual rate in the fourth quarter, the slowest quarter since the declines during the recession in 2001. Much of the slowdown was attributable to lower real consumption growth – at a 1.0 percent annual rate, down from a 4.2 percent rate in the third quarter – the slowest rate of gain in nearly 10 years. Real gross private investment spending was roughly flat, with investment in business inventories and business structures declining, but investment in residential housing and business equipment and software rising. Government spending continued to make a significant contribution to real GDP growth in the short-run as real Federal spending rose at a 10.1 percent annual rate and State and local spending rose at a 1.7 percent rate.

Productivity in the fourth quarter fell at a 0.2-percent rate for the nonfarm business sector (the standard measure). But productivity growth on a quarterly basis can be volatile. Usually it is better to focus on changes over longer periods:



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- Productivity rose 3.8 percent from the end of 2001 to the end of 2002, the biggest fourth-quarter-to-fourth-quarter growth rate since 1992. Measured on an annual average basis, productivity soared 4.7 percent in 2002, the biggest such increase since 1950.

- By comparison, the "trend" rate of productivity growth was only about 1½ percent for the 1973-1995 period.

On balance, the recent data reinforce the view that a sustained, elevated productivity growth trend is continuing. Ultimately, sustained higher productivity growth means higher real wages, higher standards of living, and lower inflation pressures. In the short run, however, strong productivity growth means businesses can continue to increase output without increasing worker hours and jobs.

Blue Chip Outlook

The February Blue Chip survey of private forecasters shows that the economy is expected to improve gradually during 2003 (see table below). Growth in real gross domestic product [GDP] is expected to rise from the 0.7-percent rate of the fourth quarter, to a 2.6-percent rate in the first quarter of this year, and a 3.2 percent rate in the second quarter. In the second half of 2003 and through 2004, real GDP growth is expected to be at or above 3½ percent. The unemployment rate is expected to rise to 6.1 percent in the first quarter, and then only gradually to decline below 6 percent over the rest of the year and into 2004.

Persisting Uncertainty and Risks

The role of uncertainty in the outlook is illustrated by recent survey information and policy statements:

Blue Chip Economic Outlook, February 2003

	2002.4	2003.1	2003.2	2003.3	2003.4	2004 Avg.
			(percent)			
Real GDP Growth	0.7	2.6	3.2	3.7	3.8	3.5
Unemployment Rate	5.9	6.1	6.0	5.9	5.8	5.6
CPI Inflation	2.5	2.4	2.0	2.0	2.2	2.4
3-month Treasury Bill	1.3	1.2	1.3	1.5	1.8	2.9
10-year Treasury Note	4.0	4.1	4.2	4.4	4.7	5.2

Note: For 2004, rate of change is for 4th quarter 2003 to 4th quarter 2004; annual average levels for unemployment and interest rates.

- The January Blue Chip survey assessed the top negative factor for economic growth in 2003 as follows: "Geo-political risk (war with Iraq, Korea, terrorism) keeps risk aversion high, hurts consumer spending, business investment, stock market." The top positive factor cited was "reduced risk aversion bolsters consumer spending and business investment, lifts stock market."

- Fully half the respondents to a survey by the National Association of Business Economists [NABE] identified a "political event connected with Middle East" and "another terrorist attack in the U.S." as the greatest risks to the economic outlook. In a separate NABE industry survey, respondents said poor profit momentum and macroeconomic uncertainty were the most important factors holding back their capital spending plans over the next 6 months. They also said an unexpectedly long war with Iraq presents the greatest threat to their firms' financial performance this year.

- The Federal Reserve's Federal Open Market Committee [FOMC], after its January monetary policy meeting, stated that: "Oil price premiums and other aspects of geopolitical risks have reportedly fostered continued restraint on spending and hiring by businesses. However, the Committee believes that as those risks lift, as most analysts expect, the accommodative stance of monetary policy, coupled with ongoing growth in productivity, will provide support to an improving economic climate over time."

Fed Policy on Hold; President Submits Budget

Despite the persisting uncertainty and its negative effects, the FOMC in January left the Federal funds rate – the key policy interest rate – unchanged at 1.25 percent. This week, Fed Chairman Greenspan testified before House and Senate committees as part of the semiannual Monetary Policy Report to Congress. He stated: "The intensification of geopolitical risks makes discerning the economic path ahead especially difficult." Still, Greenspan and the Fed, through recent policy inaction and opposition to further stimulus, apparently are implicitly assuming that the prevailing uncertainties and negative effects will soon be eliminated – and that these are the only impediments to stronger growth.

In contrast, the President believes additional action is necessary to assure improvement in the economy. His fiscal year 2004 budget includes a package of tax relief proposals intended to help boost the short- and long-run growth of the economy and jobs.

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